

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933  
Release No. 9313 / April 16, 2012

SECURITIES EXCHANGE ACT OF 1934  
Release No. 66815 / April 16, 2012

INVESTMENT COMPANY ACT OF 1940  
Release No. 30034 / April 16, 2012

ADMINISTRATIVE PROCEEDING  
File No. 3-14848



In the Matter of

optionsXpress, Inc.,  
Thomas E. Stern, and  
Jonathan I. Feldman,

Respondents.

**ANSWER TO ORDER INSTITUTING  
ADMINISTRATIVE AND CEASE-  
AND-DESIST PROCEEDINGS  
PURSUANT TO SECTION 8A OF THE  
SECURITIES ACT OF 1933,  
SECTIONS 15(b) AND 21C OF THE  
SECURITIES EXCHANGE ACT OF  
1934, AND SECTION 9(b) OF THE  
INVESTMENT COMPANY ACT OF  
1940 AND NOTICE OF HEARING**

Respondent optionsXpress Inc., by and through its counsel, Winston & Strawn LLP, hereby answers the allegations of the Division of Enforcement in its Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8a of the Securities Act of 1933, Sections 15(B) and 21c of the Securities Exchange Act of 1934, and Section 9(B) of the Investment Company Act of 1940 and Notice of Hearing ("Order"), as follows:

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections

15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against optionsXpress, Inc. ("optionsXpress") and Thomas E. Stern ("Stern"). Further, the Commission also deems it appropriate and in the public interest that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act against Jonathan I. Feldman ("Feldman").

**ANSWER:** The introductory portion of the Order Instituting Proceedings sets forth legal conclusions and related matters to which no response is required. To the extent any response is required, optionsXpress denies that it is appropriate or in the public interest that the proceedings be instituted.

## II.

After an investigation, the Division of Enforcement alleges that:

### A. SUMMARY

1. This case involves a complex short selling scheme to profit by circumventing the delivery requirements of Regulation SHO of the Exchange Act ("Reg. SHO"). From at least October 2008 to March 18, 2010, optionsXpress, Inc. ("optionsXpress"), a wholly-owned subsidiary of The Charles Schwab Corporation ("Schwab"), failed to satisfy its close-out obligations under Rules 204 and 204T of Reg. SHO by repeatedly engaging in a series of sham transactions, known as "resets," designed to give the appearance of having purchased shares to close-out an open failure-to-deliver position while in fact not doing so.

**ANSWER:** optionsXpress admits that it is a subsidiary of Schwab, and has been as such since Schwab's acquisition of optionsXpress Holdings, Inc. on September 1, 2011. optionsXpress denies the remaining allegations in Paragraph 1.

2. Further, one of optionsXpress' customers, Jonathan I. Feldman ("Feldman"), committed fraud in violation of Section 10(b) of the Exchange Act and Rules 10b-21 and 10b-5 thereunder and Section 17(a) of the Securities Act when he sold options knowing that he had no intention of fulfilling his obligations under those contracts. optionsXpress and its Chief Financial Officer ("CFO") aided and abetted Feldman in this fraud.

**ANSWER:** optionsXpress denies that it aided and abetted Feldman in the commission of fraud. optionsXpress lacks and is unable to obtain sufficient knowledge and information to form

a belief as to the truth of the remaining allegations in Paragraph 2 and, therefore, denies those allegations.

3. The sham resets were accomplished by optionsXpress facilitating its customers buying shares and simultaneously selling deep in-the-money call options that were essentially the economic equivalent of selling shares short. The purchase of shares created the illusion that the firm had satisfied the close-out obligation; however, the shares that were ostensibly purchased in the reset transactions were never actually delivered to the purchasers because on the same day the shares were "purchased," the deep in-the-money calls were exercised, thereby effectively reselling the shares.

**ANSWER:** optionsXpress denies the allegations in Paragraph 3.

4. These paired reset transactions were not bona fide purchases because their purpose was to perpetuate an open short position while giving the illusion of satisfying the delivery and close-out requirements of Reg. SHO. These sham transactions thus allowed optionsXpress and its customers to engage in what amounts to a stock-kiting scheme that deprived true stock purchasers of the benefits of ownership.

**ANSWER:** optionsXpress denies the allegations in Paragraph 4.

5. During the relevant period, optionsXpress and several customers, including Feldman, routinely engaged in these paired sham transactions in a number of securities, including Sears Holding Corporation, American International Group, Chipotle Mexican Grill, Inc., Joseph A. Bank Clothiers, Inc. and Mead Johnson Nutrition Company. As a result, optionsXpress and its customers had continuous failures to deliver in these and other securities that persisted for months, thereby undermining the purpose of Rules 204 and 204T of Reg. SHO.

**ANSWER:** optionsXpress denies the allegations in Paragraph 5.

6. These sham reset transactions also impacted the market for the issuers. For example, from January 1, 2010 to January 31, 2010, the customers who engaged in the above-described activity, including Feldman, accounted for on average 47.9% of the daily trading volume in Sears.

**ANSWER:** optionsXpress denies the allegations in Paragraph 6.

7. In 2009 alone, the six optionsXpress customer accounts in total purchased approximately \$5.7 billion worth of securities and sold short approximately \$4 billion of options. In 2009, Feldman himself purchased at least \$2.9 billion of securities and sold short at least \$1.7 billion of options through his account at optionsXpress.

**ANSWER:** The Order Instituting Proceedings fails to identify the "six customer accounts at optionsXpress" described in Paragraph 7; thus, optionsXpress lacks and is unable to

obtain sufficient knowledge and information to form a belief as to the truth of the allegations in the first sentence of Paragraph 7 and, therefore, denies those allegations. optionsXpress admits the allegations in the second sentence of Paragraph 7.

**B. RESPONDENTS**

8. optionsXpress is a Delaware corporation with a principal place of business in Chicago, IL. optionsXpress is a self-clearing, retail, on-line broker specializing in options and futures. It is a broker-dealer registered with the Commission. It is also a member of the Financial Industry Regulatory Authority ("FINRA"), the Chicago Board Options Exchange ("CBOE"), various stock exchanges, and is registered with 53 states and territories. optionsXpress was a wholly-owned subsidiary of optionsXpress Holdings, Inc. ("Holdings") until September 1, 2011, when it became a wholly-owned subsidiary of Schwab.

**ANSWER:** optionsXpress admits the allegations in Paragraph 8.

9. Stern, 66, of Chicago, IL, was the Chief Financial Officer of optionsXpress; the Chief Administrative Officer of Holdings; the President and Chief Executive Officer, Chief Compliance Officer and Director of optionsXpress International, Inc.; the Chief Financial Officer and Director of brokersXpress, LLC; and the Chief Financial Officer, Secretary, Director, and Chief Compliance Officer of OX Trading, LLC. He is a board member of the Options Clearing Corporation ("OCC"). Stern holds himself out as an options industry expert. He holds Series 3, 4, 7, 24, 27, and 63 licenses.

**ANSWER:** optionsXpress admits the allegations in the first sentence of Paragraph 9, to the extent it describes Mr. Stern's former positions at optionsXpress and OX Trading, LLC. optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the remaining allegations in Paragraph 9 and, therefore, denies those allegations.

10. Feldman, 55, of Baltimore, MD, was a retail customer of optionsXpress. In June 2010, the Office of Thrift Supervision fined Feldman for making material misrepresentations and/or concealing material facts as part of a scheme to defraud a federally-insured financial institution. He is a Senior Vice President at a regional savings bank.

**ANSWER:** optionsXpress admits that Feldman held an account at optionsXpress. optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a

belief as to the truth of the remaining allegations in Paragraph 10 and, therefore, denies those allegations.

**C. REGULATION SHO**

11. Rules 203, 204, and 204T of Reg. SHO deal with the requirement to close out failures to deliver. Rule 204T became effective on September 18, 2008 and Rule 204 became effective on July 31, 2009. 17 C.F.R. § 242.204.

**ANSWER:** This paragraph sets forth legal conclusions to which no response is required.

To the extent any response is required, optionsXpress admits that Rules 203, 204 and 204T concern the regulation of short sales, including the requirement to close out failures to deliver. optionsXpress admits that Rule 204T became effective on September 18, 2008 and Rule 204 became effective on July 31, 2009. optionsXpress otherwise denies the allegations in Paragraph 11.

12. Rules 204 and 204T require participants of a registered clearing agency to deliver equity securities to a registered clearing agency when delivery is due; that is, by settlement date. Settlement date is generally three days after the trade date ("T+3"). optionsXpress is a participant of a registered clearing agency.

**ANSWER:** This paragraph sets forth legal conclusions to which no response is required.

To the extent any response is required, optionsXpress admits that Rules 204 and 204T both state as follows: "A participant of a registered clearing agency must deliver securities to a registered clearing agency for clearance and settlement on a long or short sale in any equity security by settlement date ... ." To the extent the Commission's allegations in Paragraph 12 purport to characterize the applicable law, optionsXpress denies the allegations. optionsXpress admits that securities transactions are generally settled three days after the trade date. optionsXpress admits that it is a participant of a registered clearing agency. optionsXpress otherwise denies the allegations in Paragraph 12.

13. For short sales, if the participant does not deliver securities by T+3 and it has a failure-to-deliver position at the clearing agency, it must purchase or borrow securities of like kind and quantity to close out the failure-to-deliver position by no later than the beginning of regular trading hours on the settlement day following the settlement date ("T+4").

**ANSWER:** This paragraph sets forth legal conclusions to which no response is required.

To the extent any response is required, optionsXpress admits that Rule 204 states as follows: "or if a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in any equity security for a long or short sale transaction in that equity security, the participant shall, by no later than the beginning of regular trading hours on the settlement day following the settlement date, immediately close out its fail to deliver position by borrowing or purchasing securities of like kind and quantity." To the extent the Commission's allegations in Paragraph 13 purport to characterize the applicable law, optionsXpress denies the allegations. optionsXpress otherwise denies the allegations in Paragraph 13.

14. A participant of a clearing agency does not fulfill its requirements under Rules 204 and 204T if it enters into an arrangement with another person to purchase or borrow securities as required, and the participant knows or has reason to know that the other person will not deliver securities in settlement of the purchase or borrow. 17 C.F.R. § 242.204(f); 73 FR 61706, 61714-61715 n.78 (Oct. 17, 2008).

**ANSWER:** This paragraph sets forth legal conclusions to which no response is required.

To the extent any response is required, optionsXpress admits that Rule 204(f) states as follows: "A participant of a registered clearing agency shall not be deemed to have fulfilled the requirements of this section where the participant enters into an arrangement with another person to purchase or borrow securities as required by this section, and the participant knows or has reason to know that the other person will not deliver securities in settlement of the purchase or borrow." To the extent the Commission's allegations in Paragraph 14 purport to characterize the applicable law, optionsXpress denies the allegations. optionsXpress otherwise denies the allegations in Paragraph 14.

15. Where a participant of a clearing agency subject to the close-out requirement purchases or borrows securities on the applicable close-out date and on that same date engages in sale transactions that can be used to re-establish or otherwise extend the participant's fail position, and for which the participant is unable to demonstrate a legitimate economic purpose, the participant will not be deemed to have satisfied the close-out requirement. 74 Fed. Reg. 38266, 38272 n.82 (July 31, 2009).

**ANSWER:** This paragraph sets forth legal conclusions to which no response is required.

To the extent any response is required, optionsXpress admits that footnote 82 of the Commission's Final Rule released on July 31, 2009 states as follows: "Both temporary Rule 204T and Rule 204 require that a participant purchase or borrow shares, as applicable, to close out a fail to deliver position. Accordingly, the purchase or borrow on the applicable close-out date must be for the full quantity of the fail to deliver position that is subject to the close-out requirement. In addition, where a participant subject to the close-out requirement purchases or borrows securities on the applicable close-out date and on that same date engages in sale transactions that can be used to re-establish or otherwise extend the participant's fail position, and for which the participant is unable to demonstrate a legitimate economic purpose, the participant will not be deemed to have satisfied the close-out requirement." To the extent the Commission's allegations in Paragraph 15 purport to characterize the applicable law, optionsXpress denies the allegations. optionsXpress otherwise denies the allegations in Paragraph 15.

16. To satisfy the close-out requirements under Rules 204 and 204T, a clearing broker must take affirmative action to close out the failure-to-deliver position by purchasing or borrowing securities. 73 Fed. Reg. at 61710-11.

**ANSWER:** This paragraph sets forth legal conclusions to which no response is required.

To the extent any response is required, optionsXpress admits that the Commission's interim final temporary rule and request for comments released on October 17, 2008 states as follows: "Temporary Rule 204T(a)'s close-out requirement requires a participant of a registered clearing

agency that has a fail to deliver position at a registered clearing agency on the settlement date for a transaction to immediately borrow or purchase securities to close out the amount of the fail to deliver position by no later than the beginning of regular trading hours on the settlement day following the settlement date (the 'Close-Out Date'). This close-out requirement requires that the participant take affirmative action to purchase or borrow securities." To the extent the Commission's allegations in Paragraph 16 purport to characterize the applicable law, optionsXpress denies the allegations. optionsXpress otherwise denies the allegations in Paragraph 16.

17. In narrowly limited instances, Rules 204 and 204T provide credit for certain activity conducted by a broker-dealer prior to the occurrence of the fail. Under Rule 204's pre-fail credit provision, a broker-dealer can meet its close-out obligation by purchasing or borrowing securities after the trade date but no later than the end of regular trading hours on the settlement date of the transaction if (1) the purchase or borrow is bona fide; (2) the purchase or borrow is of a quantity of securities sufficient to cover the entire amount of the broker-dealer's failure to deliver; and (3) the broker-dealer can demonstrate that it has a net flat or net long position on its books and records on the day of the purchase or borrow. 17 C.F.R. § 242.204(e). Rule 204T contained a similar provision, however, the broker-dealer could not meet the requirements of the provision unless it purchased the shares. 17 C.F.R. § 242.204T(e).

**ANSWER:** This paragraph sets forth legal conclusions to which no response is required.

To the extent any response is required, optionsXpress admits that Rule 204(e) states as follows:

"Even if a participant of a registered clearing agency has not closed out a fail to deliver position at a registered clearing agency in accordance with paragraph (a) of this section, or has not allocated a fail to deliver position to a broker or dealer in accordance with paragraph (d) of this section, a broker or dealer shall not be subject to the requirements of paragraph (a) or (b) of this section if the broker or dealer purchases or borrows the securities, and if: (1) The purchase or borrow is bona fide; (2) The purchase or borrow is executed after trade date but by no later than the end of regular trading hours on settlement date for the transaction; (3) The purchase or

borrow is of a quantity of securities sufficient to cover the entire amount of that broker's or dealer's fail to deliver position at a registered clearing agency in that security; and (4) The broker or dealer can demonstrate that it has a net flat or net long position on its books and records on the day of the purchase or borrow." optionsXpress admits that Rule 204T(e) states as follows: "Even if a participant of a registered clearing agency has not closed out a fail to deliver position at a registered clearing agency in accordance with paragraph (a) of this section, or has not allocated a fail to deliver position to a broker or dealer in accordance with paragraph (d) of this section, a broker or dealer shall not be subject to the requirements of paragraph (a) or (b) of this section if the broker or dealer purchases securities prior to the beginning of regular trading hours on the settlement day after the settlement date for a long or short sale to close out an open short position, and if: (1) The purchase is bona fide; (2) The purchase is executed on, or after, trade date but by no later than the end of regular trading hours on settlement date for the transaction; (3) The purchase is of a quantity of securities sufficient to cover the entire amount of the open short position; and (4) The broker or dealer can demonstrate that it has a net long position or net flat position on its books and records on the settlement day for which the broker or dealer is seeking to demonstrate that it has purchased shares to close out its open short position." To the extent the Commission's allegations in Paragraph 17 purport to characterize the applicable law, optionsXpress denies the allegations. optionsXpress otherwise denies the allegations in Paragraph 17.

18. Under Rule 10b-21 of the Exchange Act, it is a manipulative or deceptive device or contrivance for any person to submit an order to sell an equity security if such person deceives a broker or dealer, a participant of a registered clearing agency, or a purchaser about its intention or ability to deliver the security on or before the settlement date, and such person fails to deliver the security on or before settlement date.

**ANSWER:** This paragraph sets forth legal conclusions to which no response is required. To the extent any response is required, optionsXpress admits that Rule 10b-21 of the Exchange Act states as follows: "It shall also constitute a 'manipulative or deceptive device or contrivance' as used in section 10(b) of this Act for any person to submit an order to sell an equity security if such person deceives a broker or dealer, a participant of a registered clearing agency, or a purchaser about its intention or ability to deliver the security on or before the settlement date, and such person fails to deliver the security on or before the settlement date." To the extent the Commission's allegations in Paragraph 18 purport to characterize the applicable law, optionsXpress denies the allegations. optionsXpress otherwise denies the allegations in Paragraph 18.

19. Rule 10b-21 and Rules 204 and 204T were adopted, among other things, to address abusive "naked" short selling and failures to deliver. Abusive "naked" short selling generally refers to selling short without having stock available for delivery and failing to deliver stock within the standard three-day settlement cycle.

**ANSWER:** This paragraph sets forth legal conclusions to which no response is required. To the extent any response is required, optionsXpress admits that the Commission's public releases associated with the Rules referenced in Paragraph 19 indicate that a purpose for the adoption of those Rules was to address abusive "naked" short selling. To the extent the Commission's allegations in Paragraph 19 purport to characterize the applicable law, optionsXpress denies the allegations. optionsXpress otherwise denies the allegations in Paragraph 19.

20. Sellers sometimes intentionally fail to deliver securities as part of a scheme to manipulate the price of a security, or possibly to avoid borrowing costs associated with short sales, especially when the costs of borrowing stock are high. Failures to deliver, however, can negatively affect purchasers of stock by depriving them of the benefits of ownership, such as voting and lending, and create a misleading impression of the market for an issuer's stock.

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 20 and, therefore, denies the allegations.

**D. ALLEGATIONS**

**The Violative Trading**

21. Six customer accounts at optionsXpress, including Feldman ("the Customers"), engaged in reverse conversions and similar options trading strategies starting no later than October 2008.

**ANSWER:** The Order Instituting Proceedings fails to identify the "six customer accounts at optionsXpress" other than Feldman's described in Paragraph 21; thus, optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 21 regarding the remaining customer accounts considered to be "the Customers" and, therefore, denies those allegations. optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the remaining allegations in Paragraph 21, and, therefore, denies those allegations.

22. To execute these strategies, the Customers simultaneously entered into the sale of a put and purchase of call with identical strike prices and expiration dates creating a synthetic long position. The Customers would also create a short position to hedge their synthetic long position. They generally did this by selling deep-in-the-money calls. The synthetic long position and the short position were for an equal number of shares/contracts. Through this set of transactions, the Customers eliminated directional risk in the stock price.

**ANSWER:** optionsXpress admits that the sale of a put and the purchase of a call creates a synthetic long position. optionsXpress admits that selling a deep-in-the-money call creates a short position. The Order Instituting Proceedings fails to identify the "six customer accounts at optionsXpress" described in the definition of "the Customers" contained in Paragraph 21; thus, optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 22 regarding the remaining customer

accounts considered to be "the Customers" and, therefore, denies those allegations. optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the remaining allegations in Paragraph 22, and, therefore, denies those allegations.

23. An option that is "deep in-the-money" has a strike price that is far below (in the case of a call option) or far above (in the case of a put) the market price for the given security.

**ANSWER:** optionsXpress admits that an option that is "deep in-the-money" has a strike price that is significantly below (in the case of a call option) or significantly above (in the case of a put) the market price for the given security. optionsXpress denies the allegations in Paragraph 23 to the extent they may be construed to state a definition of the phrases "far below" or "far above."

24. The deep-in-the-money calls sold to create the short position referenced hard-to-borrow securities and were frequently exercised. After the options were exercised and assigned to the Customers, the Customers had a synthetic long position and a short stock position for which they (and optionsXpress) were required to deliver shares by T+3.

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 24 and, therefore, denies the allegations.

25. However, neither optionsXpress nor the Customers delivered the shares by T+3 thus creating a failure-to-deliver position.

**ANSWER:** optionsXpress denies the allegations in Paragraph 25.

26. Instead of delivering the shares, optionsXpress and the Customers would give the appearance of closing out their fails by entering into a "buy-write," *i.e.*, they would simultaneously buy the shares they needed to cover the failure-to-deliver position and write (sell) deep-in-the-money calls representing an equivalent number of shares.

**ANSWER:** optionsXpress denies the allegations in Paragraph 26.

27. optionsXpress, Stern, and the Customers knew, or were reckless in not knowing, that most, if not all, the calls that were sold as part of the buy-writes would be exercised and

assigned on the same day they were sold, resulting in shares not being delivered on settlement. Thus, optionsXpress, Stern, and the Customers knew, or were reckless in not knowing, that these transactions would result in failures-to-deliver.

**ANSWER:** optionsXpress denies the allegations in Paragraph 27.

28. Selling deep-in-the-money calls is essentially the economic equivalent of selling shares unless the stock price drops precipitously and therefore approaches the strike price.

**ANSWER:** optionsXpress denies the allegations in Paragraph 28.

29. To enter into the buy-write, the Customers paid a certain amount, generally between 1 and 2 pennies per share.

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 29 and, therefore, denies the allegations.

30. The newly written deep-in-the-money calls were generally exercised the same day they were sold (and thus were assigned to the Customers later the same day) putting the Customers back in their original short position, continuing the fails, and causing them to enter into another buy-write the following day. As a result, optionsXpress maintained a net short position at the end of each day.

**ANSWER:** optionsXpress denies the allegations in Paragraph 30.

31. The buy-writes continued on a daily basis until the original synthetic long position was unwound or expired. As a result, optionsXpress had a negative position in the National Securities Clearing Corporation's ("NSCC") continuous net settlement ("CNS") system for extended periods of time.

**ANSWER:** optionsXpress denies the allegations in Paragraph 31.

32. While the daily use of buy-writes gave the impression that optionsXpress was closing out the failures to deliver as required, optionsXpress and the Customers were simply kiting stock to maintain the naked short position.

**ANSWER:** optionsXpress denies the allegations in Paragraph 32.

33. Put another way, the buy-write was a matched order entered for the improper purpose of appearing to close out delivery fails without actually delivering the shares.

**ANSWER:** optionsXpress denies the allegations in Paragraph 33.

34. The transactions were profitable for the Customers because they: (i) sold the initial position "for a credit"; (ii) took no risk with respect to the change in the price of the stock and options that occurred over the life of the position; and (iii) did not incur the costs associated with borrowing or purchasing sufficient shares to make delivery on the short sale. optionsXpress received Commissions on the transactions.

**ANSWER:** optionsXpress denies the allegations in Paragraph 34.

35. The Customers received a net credit for their initial position because of a difference in the relative value of the put and the call. Normally, the price of the put and the call will be in parity; however, the stock associated with the options traded by the Customers was generally hard-to-borrow and therefore expensive to borrow. Because of this, the cost of borrowing the stock was incorporated into the price of the put. Thus, the value of the put was higher relative to the value of the call.

**ANSWER:** optionsXpress denies the allegations in Paragraph 35.

36. Due to the cost of borrowing such hard-to-borrow stocks, the increased price the Customers received for selling the put would have been completely offset by the cost of instituting and maintaining the stock position, had optionsXpress and the Customers complied with their delivery obligations. In order to comply with those obligations, they would have had to borrow or purchase shares of the underlying stock in order to close-out the failure-to-deliver position.

**ANSWER:** optionsXpress denies the allegations in Paragraph 36.

37. By engaging in the buy-writes and thus having a constant unsettled stock position, optionsXpress and the Customers were able to evade the requirements of Reg. SHO at a relatively minimal cost, thereby maintaining the profitability of the trade.

**ANSWER:** optionsXpress denies the allegations in Paragraph 37.

38. By not delivering shares, optionsXpress and its Customers were extracting a profit at the expense of the true purchasers of the shares. There was no legitimate economic purpose to the buy-write transactions.

**ANSWER:** optionsXpress denies the allegations in Paragraph 38.

39. Indeed, the buy-writes standing alone were economically nonsensical because they cost the Customers money. Their purpose was to perpetuate a failure to deliver. This is not a legitimate economic purpose.

**ANSWER:** optionsXpress denies the allegations in Paragraph 39.

40. optionsXpress' website notes that under normal circumstances the chance to execute profitable reverse conversions is extremely limited: "Individual investors and most other off-the-floor traders don't have an opportunity to do conversions and reversals because price discrepancies typically only exist for a matter of moments. Professional option traders, on the other hand, are constantly on the lookout for these opportunities. As a result, the market quickly returns to equilibrium."

**ANSWER:** optionsXpress admits that its website contains the quoted text.

optionsXpress denies the remaining allegations in Paragraph 40.

41. From at least October 7, 2008 to March 18, 2010, the Customers conducted the trading strategy described above in the following securities and time periods.

| Security                                | Ticker | 1st Buy-Write | Last Buy-Write |
|---|--------|---------------|----------------|
| American International Group, Inc.      | AIG    | 11/23/2009    | 1/6/2010       |
| American International Group, Inc.      | AIG    | 7/23/2009     | 10/7/2009      |
| AMEDISYS Inc.                           | AMED   | 12/30/2009    | 2/17/2010      |
| AMEDISYS Inc.                           | AMED   | 2/22/2010     | 3/18/2010      |
| A-Power Energy Generation Systems, Ltd. | APWR   | 11/5/2009     | 11/10/2009     |
| A-Power Energy Generation Systems, Ltd. | APWR   | 11/20/2009    | 11/30/2009     |
| A-Power Energy Generation Systems, Ltd. | APWR   | 3/4/2010      | 3/10/2010      |
| BioCryst Pharmaceuticals, Inc.          | BCRX   | 11/16/2009    | 12/17/2009     |
| Citigroup, Inc.                         | C      | 6/19/2009     | 7/24/2009      |
| Chipotle Mexican Grill, Inc.            | CMG    | 7/29/2009     | 8/12/2009      |
| Chipotle Mexican Grill, Inc.            | CMG    | 11/23/2009    | 12/17/2009     |
| Chipotle Mexican Grill, Inc.            | CMG    | 9/11/2009     | 11/12/2009     |
| Chipotle Mexican Grill, Inc.            | CMG    | 1/2/2009      | 1/21/2009      |
| Chipotle Mexican Grill, Inc.            | CMG    | 6/26/2009     | 7/21/2009      |
| China Sky One Medical, inc.             | CSKI   | 1/12/2010     | 2/17/2010      |
| Direxion Daily Financial Bull 3X Shares | FAS    | 10/8/2009     | 11/23/2009     |
| FUQI International, Inc.                | FUQI   | 12/7/2009     | 1/11/2010      |
| Greenhill & Co., Inc.                   | GHL    | 12/29/2008    | 2/23/2009      |
| Greenhill & Co., Inc.                   | GHL    | 12/9/2008     | 12/17/2008     |
| Interoil Corporation                    | IOC    | 4/3/2009      | 5/12/2009      |
| Interoil Corporation                    | IOC    | 5/15/2009     | 5/22/2009      |
| Jos. A. Bank Clothiers Inc.             | JOSB   | 10/7/2008     | 10/21/2008     |
| Jos. A. Bank Clothiers Inc.             | JOSB   | 11/11/2008    | 11/20/2008     |
| Jos. A. Bank Clothiers Inc.             | JOSB   | 10/29/2008    | 11/5/2008      |
| Jos. A. Bank Clothiers Inc.             | JOSB   | 12/9/2008     | 12/12/2008     |
| Jos. A. Bank Clothiers Inc.             | JOSB   | 1/23/2009     | 2/24/2009      |
| Life Partners Holdings, Inc.            | LPHI   | 2/22/2010     | 3/18/2010      |

| Security                              | Ticker | 1st Buy-Write | Last Buy-Write |
|---------------------------------------|--------|---------------|----------------|
| Life Partners Holdings, Inc.          | LPHI   | 2/2/2010      | 2/12/2010      |
| Mead Johnston Nutritional Company     | MJN    | 11/27/2009    | 12/8/2009      |
| Mead Johnston Nutritional Company     | MJN    | 12/10/2009    | 12/18/2009     |
| MannKind Corp.                        | MNKD   | 12/29/2009    | 2/17/2010      |
| M&T Bank Corp.                        | MTB    | 7/2/2009      | 9/17/2009      |
| M&T Bank Corp.                        | MTB    | 3/24/2009     | 4/14/2009      |
| OSIRIS Therapeutics, Inc.             | OSIR   | 10/5/2009     | 10/13/2009     |
| RINO International Corporation        | RINO   | 3/11/2010     | 3/17/2010      |
| Origin Agritech Limited               | SEED   | 12/1/2009     | 12/23/2009     |
| Sears Holding Corporation             | SHLD   | 10/7/2008     | 3/24/2009      |
| Sears Holding Corporation             | SHLD   | 4/8/2009      | 3/18/2010      |
| Shanda Interactive Entertainment Ltd. | SNDA   | 7/21/2009     | 9/17/2009      |
| Synaptics Inc.                        | SYNA   | 1/5/2010      | 2/17/2010      |
| The Talbots Inc.                      | TLB    | 2/5/2010      | 3/18/2010      |
| Texas Industries Inc.                 | TXI    | 8/17/2009     | 10/13/2009     |
| Under Armour, Inc.                    | UA     | 7/10/2009     | 7/20/2009      |
| Under Armour, Inc.                    | UA     | 7/30/2009     | 8/10/2009      |

**ANSWER:** The Order Instituting Proceedings fails to identify the “six customer accounts at optionsXpress” described in the definition of “the Customers” contained in Paragraph 21; Paragraph 41 is also unclear and ambiguous as to the definition of “trading strategy described above”; thus, optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 41 and, therefore, denies the allegations.

42. As a result of the trading, optionsXpress had a continuous failure-to deliver position in these securities for extended periods of time. For instance, optionsXpress had a failure-to-deliver position in Sears for at least 236 continuous settlement days during the 2009-2010 period. In total during the relevant period, optionsXpress had failures to deliver in at least 25 issuers at least 1,317 times.

**ANSWER:** optionsXpress denies the first sentence of Paragraph 42. optionsXpress denies the allegations in the second sentence of Paragraph 42, except that optionsXpress admits it had a failure-to-deliver position in Sears, while complying with Reg. SHO, on each day for at least 236 consecutive settlement days during the 2009-2010 period. optionsXpress lacks and is

unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in the third and final sentence of Paragraph 42 and, therefore, denies those allegations.

43. During this period, the NSCC sent optionsXpress numerous notices of intention to buy-in for many of the securities listed above. NSCC sends these notices to the clearing broker with the oldest failure-to-deliver position when requested to do so by clearing brokers with failures to receive.

**ANSWER:** optionsXpress admits that it received notices of intention to buy-in from NSCC. optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the remaining allegations in Paragraph 43 and, therefore, denies those allegations.

44. From at least June 2009 to March 18, 2010, Feldman conducted the trading strategy described above in at least the following securities and time periods:

| Security                                | Ticker | 1st Buy-Write | Last Buy-Write |
|---|--------|---------------|----------------|
| American International Group, Inc.      | AIG    | 7/29/2009     | 10/2/2009      |
| AMEDISYS Inc.                           | AMED   | 1/7/2010      | 2/12/2010      |
| AMEDISYS Inc.                           | AMED   | 2/23/2010     | 3/17/2009      |
| A-Power Energy Generation Systems, Ltd. | APWR   | 11/5/2009     | 11/10/2009     |
| A-Power Energy Generation Systems, Ltd. | APWR   | 11/20/2009    | 11/30/2009     |
| A-Power Energy Generation Systems, Ltd. | APWR   | 3/4/2010      | 3/10/2010      |
| Citigroup, Inc.                         | C      | 6/19/2009     | 7/24/2009      |
| China Sky One Medical, inc.             | CSKI   | 1/12/2010     | 2/17/2010      |
| Mead Johnston Nutritional Company       | MJN    | 11/27/2009    | 12/8/2009      |
| Mead Johnston Nutritional Company       | MJN    | 12/10/2009    | 12/18/2009     |
| Life Partners Holdings, Inc.            | LPHI   | 2/2/2010      | 2/12/2010      |
| Life Partners Holdings, Inc.            | LPHI   | 2/22/2010     | 3/18/2010      |
| OSIRIS Therapeutics, Inc.               | OSIR   | 10/5/2009     | 10/13/2009     |
| Origin Agritech Limited                 | SEED   | 12/4/2009     | 12/17/2009     |
| Sears Holding Corporation               | SHLD   | 9/22/2009     | 11/12/2009     |
| Sears Holding Corporation               | SHLD   | 12/2/2009     | 3/9/2010       |
| The Talbots Inc.                        | TLB    | 2/16/2010     | 3/18/2010      |
| Texas Industries Inc.                   | TXI    | 8/20/2009     | 10/13/2009     |
| Under Armour, Inc.                      | UA     | 7/10/2009     | 7/20/2009      |
| Under Armour, Inc.                      | UA     | 7/30/2009     | 8/10/2009      |

**ANSWER:** Paragraph 44 is ambiguous as to the definition of “trading strategy described above”; thus optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 44 or the table contained in Paragraph 44 and, therefore, denies the allegations.

45. The daily volume of the Customers’ trades in some of these issuers was a significant portion of the securities’ total daily trading volume. For example, between January 1, 2010 and January 31, 2010, the Customers traded between 832,100 shares and 1,603,000 shares of Sears Holding Corporation (“Sears”) stock a day which accounted for between 15.6% and 62.2% of Sears’ daily trading volume. On average in the month of January 2010, the Customers accounted for 47.9% of the daily trading volume in Sears.

**ANSWER:** The Order Instituting Proceedings fails to identify the “six customer accounts at optionsXpress” described in the definition of “the Customers” contained in Paragraph 21; thus, optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 45 and, therefore, denies the allegations.

46. In 2009, the Customers combined purchased a total of approximately \$5.7 billion worth of securities and sold short a total of approximately \$4 billion of options through their accounts at optionsXpress. In 2009, Feldman purchased at least \$2.9 billion of securities and sold short at least \$1.7 billion of options through his account at optionsXpress.

**ANSWER:** The Order Instituting Proceedings fails to identify the “six customer accounts at optionsXpress” described in the definition of “the Customers” contained in Paragraph 21; thus, optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in the first sentence of Paragraph 46 and, therefore, denies those allegations. optionsXpress admits the allegations in the second sentence of Paragraph 46.

**The Law Was Clear: The Reset Transactions Were Violations of Reg. SHO**

47. In 2003, the SEC issued guidance to “disabuse traders of any notion” that a married stock/option trade designed to give the appearance of a long position could be used to

circumvent regulatory requirements. SEC Interpretive Rel. 34-48795 (Nov. 21, 2003). “Even viewed in the most favorable light, these married put transactions appear to be nothing more than temporary stock lending agreements designed to give the appearance of a ‘long’ position in order to effect sales of stock in a manner that would otherwise be prohibited.” *Id.* “The Commission has previously indicated that where transactions involve no market risk and serve no purpose other than rendering a person an owner of a security in order to accomplish indirectly what was prohibited directly, the activity may violate the federal securities laws.” *Id.*

**ANSWER:** This paragraph sets forth legal conclusions to which no response is required.

To the extent any response is required, optionsXpress admits that SEC Interpretive Rel. 34-48795 contains the quoted text. optionsXpress admits that the document further states as follows regarding the strategies about which the Commission was expressing its concern: “These married transactions have been used in connection with various trading strategies, including, but not limited to, the following: [1] contemporaneously with or shortly after the purchase of a married put, stock sales are made without regard to the ‘tick test’ as part of a day trading strategy dependent on trading without short sale price test execution delays in order to profit from rapid intra-day trades to take advantage of small price movements in stocks, [2] contemporaneously with or shortly after the purchase of a married put, aggressive, rapid stock sales on successive minus or zero-minus ticks as part of a short-term momentum play in which a trader’s strategy is aligned with a downward movement of the stock’s price, or [3] contemporaneously with or shortly after the purchase of a married put, aggressive stock sales are made during the 5-day period prior to the pricing of a secondary or repeat offering where the trader’s strategy is aligned with a downward movement of the stock’s price in an effort to profit from the difference between the sales prices and the offering price.” To the extent the Commission’s allegations in Paragraph 47 purport to characterize the applicable law, optionsXpress denies the allegations.

48. In July 2007, the American Stock Exchange (“AMEX”) fined several entities and individuals for violating Reg. SHO Rule 203 based on trading activity similar to what the Customers were doing. *In the Matter of Scott H. Arenstein and SBA Trading, LLC (July 20,*

2007); *In the Matter of Brian A. Arenstein and ALA Trading, LLC* (July 20, 2007). In the *Arenstein* cases, the respondents engaged in a series of reset transactions, mostly married puts, but also some buy-writes, that employed short-term options to circumvent the close-out obligation of Rule 203.

**ANSWER:** This paragraph sets forth legal conclusions to which no response is required. To the extent any response is required, optionsXpress admits that the stipulated facts in the settled cases cited in Paragraph 48 describe the respondents in those cases utilizing certain types of transactions, including buy-writes. optionsXpress admits that the respondents in those cases were fined for violating Reg. SHO. optionsXpress denies the remaining allegations in Paragraph 48.

49. Following the release of the *Arenstein* cases, CBOE sent a regulatory circular to its members, including optionsXpress, “strongly cautioning” its members that transactions “pairing the close-out with one or more short-term options positions that are utilized to reverse that close-out are deemed improper reset arrangements that do not satisfy the Regulation SHO close-out requirement.” CBOE Regulatory Circular RG07- 87 (Aug. 9, 2007). “Short sales of threshold securities (that result in fails to deliver) paired with one or more short-term option transactions, for example, including, but not limited to, *reverse conversions and deep in-the-money long call/short stock*, are highly indicative of transactions that may be assisting a contra-party faced with a close-out obligation in creating the appearance of a bona-fide stock purchase.” *Id.* (emphasis added). CBOE then noted that while its examples involved market-makers, “the same analysis would apply to similar arrangements between any market participants.” *Id.*

**ANSWER:** This paragraph sets forth legal conclusions to which no response is required. To the extent any response is required, optionsXpress admits that CBOE Regulatory Circular RG07-87 states as follows with respect to a specific example of particular activity described in the document involving a market maker: “The Exchange strongly cautions members that, in the transaction described above, pairing the close-out with one or more short-term option positions that are utilized to reverse that close-out are deemed improper reset arrangements that do not satisfy the Regulation SHO close-out requirement.” optionsXpress admits that CBOE Regulatory Circular RG07-87 further states as follows: “Short sales of threshold securities (that result in fails to deliver) paired with one or more short-term option transactions, for example

including, but not limited to, reverse conversions and deep in-the-money long call / short stock, are highly indicative of transactions that may be assisting a contra-party faced with a close-out obligation in creating the appearance of a bona-fide stock purchase.” optionsXpress admits that CBOE Regulatory Circular RG07-87 contains the final quoted excerpt in Paragraph 49. To the extent the Commission’s allegations in Paragraph 49 purport to characterize the applicable law or CBOE’s positions or opinions, optionsXpress denies the allegations.

50. The following year, CBOE reiterated its caution: “When accompanied by certain option transactions, stock purchases that are intended to effect close-outs of fail to deliver positions may bring into question whether a bona-fide purchase has occurred.” The Circular also noted that while it was permissible to re-establish a short stock position the business day following a close-out, “if the underlying stock purchase was not bona-fide or did not completely satisfy any close-out requirement, a pre-borrow of stock is required for the subsequent establishment of the new short stock position on the following business day until the close-out is satisfied.” CBOE Regulatory Circular RG08-63.

**ANSWER:** This paragraph sets forth legal conclusions to which no response is required.

To the extent any response is required, optionsXpress admits that CBOE Regulatory Circular RG08-63 states as follows: “When accompanied by certain option transactions, stock purchases that are intended to effect close-outs of fail to deliver positions may bring into question whether a bona-fide purchase has occurred.” optionsXpress admits that CBOE Regulatory Circular RG08-63 further states as follows: “It is permissible to re-establish a short stock position (and, if desired, offsetting options positions) the business day following a close-out. However, if the underlying stock purchase was not bona-fide or did not completely satisfy any close-out requirement, a pre-borrow of stock is required for the subsequent establishment of the new short stock position on the following business day until the close-out is satisfied.” To the extent the Commission’s allegations in Paragraph 50 purport to characterize the applicable law or CBOE’s positions or opinions, optionsXpress denies the allegations.

51. The CBOE regulatory circulars were reviewed by optionsXpress' compliance officers in connection with the trading.

**ANSWER:** optionsXpress admits that Philip Hoeh and Jay Risley reviewed certain CBOE circulars related to Reg. SHO. optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the remaining allegations in Paragraph 51 and, therefore, denies the allegations.

52. On October 14, 2008, the SEC adopted Rule 204T noting that "the purchase of paired positions of stock and options that are designed to create the appearance of a bona fide purchase of securities but that are nothing more than a temporary stock lending arrangement would not satisfy Regulation SHO's close-out requirement." 73 Fed. Reg. at 61715 n.78.

**ANSWER:** This paragraph sets forth legal conclusions to which no response is required. To the extent any response is required, optionsXpress admits that footnote 78 of the Commission's interim final temporary rule and request for comments released on October 17, 2008 states as follows: "[W]e note that borrowing securities, or otherwise entering into an arrangement with another person to create the appearance of a purchase would not satisfy the close-out requirement of Regulation SHO. For example, the purchase of paired positions of stock and options that are designed to create the appearance of a bona fide purchase of securities but that are nothing more than a temporary stock lending arrangement would not satisfy Regulation SHO's close-out requirement." To the extent the Commission's allegations in Paragraph 52 purport to characterize the applicable law, optionsXpress denies the allegations.

53. In July 2009, when the SEC adopted Rule 204 it reiterated its guidance: "where a participant subject to the close-out requirement purchases or borrows securities on the applicable close-out date and on that same date engages in sale transactions that can be used to re-establish or otherwise extend the participant's fail position, and for which the participant is unable to demonstrate a legitimate economic purpose, the participant will not be deemed to have satisfied the close-out requirement." 74 Fed. Reg. at 38272 n.82.

**ANSWER:** This paragraph sets forth legal conclusions to which no response is required. To the extent any response is required, optionsXpress admits that footnote 82 of the

Commission's final rule released on July 31, 2009 states as follows: "[W]here a participant subject to the close-out requirement purchases or borrows securities on the applicable close-out date and on that same date engages in sale transactions that can be used to re-establish or otherwise extend the participant's fail position, and for which the participant is unable to demonstrate a legitimate economic purpose, the participant will not be deemed to have satisfied the close-out requirement." To the extent the Commission's allegations in Paragraph 53 purport to characterize the applicable law, optionsXpress denies the allegations.

54. Less than a month later, the SEC brought settled enforcement actions against several entities and individuals regarding similar options trading and violations of Rule 203. *In the Matter of Hazan Capital Management, LLC and Steven M. Hazan, Exchange Act Release No. 34-60441 (Aug. 5, 2009); In the Matter of TJM Proprietary Trading, LLC, Michael R. Benson, and John T. Burke, Exchange Act Release No. 34-60440 (Aug. 5, 2009).* In the *Hazan and TJM* cases, the respondents engaged in a series of sham reset transactions that employed short-term paired stock and options positions (married puts and/or buy-writes using both FLEX options and standard exchange-traded options) to circumvent the close-out obligations of Rule 203.

**ANSWER:** This paragraph sets forth legal conclusions to which no response is required. To the extent any response is required, optionsXpress admits that the Commission brought the settled enforcement actions cited in Paragraph 54 on August 5, 2007. optionsXpress admits that the stated facts in the *Hazan* case cited in Paragraph 54 speak for themselves. optionsXpress denies the remaining allegations in Paragraph 54.

55. Three months later, the SEC brought settled enforcement actions against several other entities regarding similar trading and violations of Reg. SHO. *In the Matter of Rhino Trading, Fat Squirrel Trading Group, Damon Rein, and Steven Peter, Exchange Act Release No. 34-60941 (Nov. 4, 2009).*

**ANSWER:** This paragraph sets forth legal conclusions to which no response is required. To the extent any response is required, optionsXpress admits that the Commission brought the settled enforcement actions cited in Paragraph 55 on November 4, 2009. optionsXpress denies the remaining allegations in Paragraph 55.

### Red Flags

56. optionsXpress knew early on that the trading was problematic. On October 15, 2008, less than one month after the Commission issued its emergency order putting Rule 204T into effect, one of optionsXpress' traders sent an internal email which described the trading: "the customer has short positions on hard to borrow stocks where the customer has to buy in every day. Our customer is buying back the short and writing in the money calls which are assigned on a daily basis."

**ANSWER:** optionsXpress denies the first sentence of Paragraph 56. optionsXpress admits that an email was sent by an optionsXpress employee on October 15, 2008 containing the quoted language in Paragraph 56. optionsXpress denies the remaining allegations in Paragraph 56.

57. In late October 2008, the Clearing Department raised concerns that the stock was not being bought in at market open. The Compliance Department replied back to the Clearing Department and the traders telling them: "According to the rules, they need to be closed out at the opening. The industry is pushing back on this, and requesting the [whole] day, but as it is now, we need to cover at the open." Nonetheless, the Compliance Department did not subsequently follow up with the Clearing Department to ensure that failures to deliver were in fact bought in at market open.

**ANSWER:** optionsXpress admits that an email was sent by an optionsXpress employee on October 27, 2008 containing the quoted language in Paragraph 57. optionsXpress denies the remaining allegations in Paragraph 57.

58. The following month, the optionsXpress Clearing Department informed an optionsXpress senior officer of the "vicious cycle" that the buy-writes were causing: "Since we have an open CNS fail and as soon as we buy to cover, the customer shorts a call which gets assigned immediately, we are in a vicious cycle."

**ANSWER:** optionsXpress admits that an email was sent by an optionsXpress employee on November 5, 2008 containing the quoted language in Paragraph 58. optionsXpress denies the remaining allegations in Paragraph 58.

59. In mid-November 2008, the optionsXpress senior officer sent an email to the Clearing Department about a *Wall Street Journal* article describing the trading activity in the *Arenstein* case and noting that the FINRA had several cases involving this activity: "There is an article in the WSJ about how short sellers in [Sears] are using options to circumvent the SEC

cover rule. I think we need to review this.” The Clearing Department emailed back: “[The Customers are] definitely doing this.”

**ANSWER:** optionsXpress admits that an email was sent by an optionsXpress employee on November 13, 2008 containing the quoted language in Paragraph 59. optionsXpress denies the remaining allegations in Paragraph 59.

60. The Clearing Department also raised its concerns to the Compliance Department noting that the trading was “suspicious.” The Compliance Department reached out to the trader who executed the buy-writes and he explained the process again:

“What he’s doing is short covering on hard to borrow stock. It’s cheaper for him to do the deep in the money buy write and get assigned the next day than to put on a married put.”

**ANSWER:** optionsXpress admits that emails were sent by optionsXpress employees on November 24, 2008 containing the quoted language in Paragraph 60. optionsXpress denies the remaining allegations in Paragraph 60.

61. Despite this and other indications that optionsXpress was aware of the Customers’ trading strategy, optionsXpress told FINRA in an August 10, 2009 letter that “OXPS did not know—and could not know—the customers’ motive for selling calls. . . . We do not know, and cannot speculate, as to the motive for the strategy employed by our customers. Therefore, although maintenance of a short position in GHL may have been a result of the customers’ actions, OXPS does not know the customers’ motives during the review period.”

**ANSWER:** optionsXpress admits that a letter was sent to the Market Regulation Department at FINRA on August 10, 2009 containing the quoted language in Paragraph 61. optionsXpress denies the remaining allegations in Paragraph 61.

62. Starting in November 2008, CBOE began asking optionsXpress for information related to its Reg. SHO compliance. On February 26, 2009, CBOE notified optionsXpress that it was investigating the trading to determine whether SEC Rule 204T had been violated. Stern, who functioned as optionsXpress’ primary regulatory liaison, was also involved in the response to CBOE’s investigation and reviewed the Customers’ trading.

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 62 and, therefore, denies the allegations.

63. In May 2009, FINRA initiated its first investigation related to the activity described above.

**ANSWER:** optionsXpress denies the allegations in Paragraph 63.

64. In July 2009, optionsXpress asked an exchange for a fee modification for the buy-writes. As part of the request, an optionsXpress' senior officer noted that "[w]e do have some larger retail clients that have developed some 'predictable' strategies/behavior."

**ANSWER:** optionsXpress admits that an employee contacted an exchange regarding a proposed refund of fees. optionsXpress admits that an email was sent on July 15, 2009 containing the quoted language in Paragraph 64. optionsXpress denies the remaining allegations in Paragraph 64.

65. According to the optionsXpress' senior officer, the market makers using the exchange had begun to anticipate the buy-writes – meaning that the counterparties to the buy-writes were anticipating that the buy-writes would occur each day. Because of the fees at the exchange, optionsXpress worked to find another market for the buy-writes.

**ANSWER:** optionsXpress admits that its employee stated that other market participants anticipated certain orders by optionsXpress customers. optionsXpress admits that on July 15, 2009, its employee told the exchange representative that optionsXpress would "trade these elsewhere." optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the remaining allegations in Paragraph 65 and, therefore, denies those allegations.

**optionsXpress Institutes a Policy for "Perpetual" Buy-Ins**

66. On August 5, 2009, the SEC instituted the Hazan and TJM actions. The following day, a trader at optionsXpress notified the Customers that "[u]nfortunately we will need to change how buy ins are covered. . . . This means once we get the buy in lists, the shares will need

to be covered immediately in the morning. I apologize for this unfortunate change, but the SEC won't budge on these rules."

**ANSWER:** optionsXpress admits that the SEC instituted the *Hazan* and *TJM* actions on August 5, 2009. optionsXpress admits that an email was sent by an optionsXpress employee to Feldman on August 6, 2009 containing the following text: "Unfortunately we will need to change how buy ins are covered. The SEC has decided to make the buy in rule permanent, however, they did not approve the buy ins to be covered by the end of the trading day. This means once we get the buy in lists, the shares will need to be covered immediately in the morning. I apologize for this unfortunate change, but the SEC won't budge on these rules." optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the remaining allegations in Paragraph 66 and, therefore, denies those allegations.

67. In response to a question from Feldman, a trader at optionsXpress elaborated: "Compliance has also notified me that this could change further by having us place the covers in your account at the market, and have the customer place any option orders."

**ANSWER:** optionsXpress admits that an email was sent to Feldman on August 6, 2009 containing the quoted language in Paragraph 67. optionsXpress denies the remaining allegations in Paragraph 67.

68. Despite the Compliance Department's advice in 2008 discussed above in paragraph 57, optionsXpress was still not placing the buy-in orders at market open. In fact, optionsXpress never consistently executed the buy-writes at or near market open.

**ANSWER:** optionsXpress denies the allegations in Paragraph 68.

69. On August 10, 2009, one of optionsXpress' traders emailed the Compliance Department with concerns about the short sale process: "[W]e're still getting the buy in report pretty late in the morning." He then raised concerns about optionsXpress' stock borrowing process noting that the "SEC is really cracking down on this."

**ANSWER:** optionsXpress admits that an email was sent by an optionsXpress employee to another employee on August 10, 2009 containing the quoted language in Paragraph 69. optionsXpress denies the remaining allegations in Paragraph 69.

70. Later the same day the trader noted that buy-ins were another issue: "I know we're the traders over here, but it seems we're giving them too much leeway with these buy writes instead of covering them on the short shares first." The Compliance Department responded: "I agree that we need to tighten up our procedures on the buy-ins. To do this, we will no longer allow customers to conduct their own buys. We will process the buy-in for each account at the open."

**ANSWER:** optionsXpress admits that an email exchange occurred between optionsXpress employees on August 14, 2009 containing the quoted language in Paragraph 70. optionsXpress denies that this email exchange occurred "later on the same day" as the email described in Paragraph 69. optionsXpress denies the remaining allegations in Paragraph 70.

71. The decision to no longer allow customers to conduct their own buy-ins was made by a group of people that included Stern.

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 71 and, therefore, denies the allegations.

72. On August 19, 2009, optionsXpress' Compliance Department instituted new buy-in procedures. The decision to implement the new procedures was made by a group, including Stern. In addition, Stern oversaw the implementation of the new procedures and in the process, became intimately familiar with the Customers' trading activity.

**ANSWER:** optionsXpress admits that on August 19, 2009, optionsXpress revised and implemented procedures to cover the entire short position for certain stocks failing for three out of five consecutive days. optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the remaining in Paragraph 72 and, therefore, denies those allegations.

73. The new procedures called for two buy-in lists instead of one: a regular list and a list of failure-to-deliver positions where "the fail is continuously open due to customers being assigned in the money short calls," also known internally as the "perpetual," "chronic," or "rolling fails" list. There were different procedures for the two lists.

**ANSWER:** optionsXpress admits that it employed procedures to effect buy-ins "[i]f [a] fail [was] continuously open due to customers being assigned in the money short calls." optionsXpress admits that it used separate lists that employed different procedures. optionsXpress admits that an optionsXpress employee testified about using the terms "chronic" or "perpetual list" as a shorthand way of referring to those stocks that optionsXpress bought in on a frequent basis. optionsXpress denies the remaining allegations in Paragraph 73.

74. After the new procedures were instituted, one of optionsXpress' traders asked the Clearing Department what qualifies as a "perpetual buy in." The Clearing Department replied: "Always short, covers your buys by buying [sic] short options deep in the money, so they get assigned. More or less, their trade date position stays constant, settled position never closes or goes long."

**ANSWER:** optionsXpress admits that an email exchange occurred between optionsXpress employees on August 19, 2009 containing the quoted language in Paragraph 74. optionsXpress admits that this occurred after new procedures were instituted. optionsXpress denies the remaining allegations in Paragraph 74.

75. According to an optionsXpress compliance officer, a "perpetual fail" was "a fail where the issue, specific issue or security is failing a number of days...to me it would be if firms didn't close out the fail and left it alone and it would be a perpetual fail if they didn't meet their close-out obligations and let that fail continue." He also noted that "the rule requires us to reduce that fail to deliver, so you would violate Rule, you know, 203 and 204 if you had a fail and you didn't close it out within the required time frames."

**ANSWER:** optionsXpress admits that the transcript of an optionsXpress compliance officer's testimony contains the quoted text.

76. After the new procedures were issued, an optionsXpress senior officer followed up with the trading desk saying: "Did we contact our largest clients?" An optionsXpress trader responded: "Definitely, spent a lot of time on the phone with Feldman [and the other Customers]

yesterday.” The traders communicated to the Customers that: “Basically they have told us our practices our [sic] not consistent with the rules, and that changes must be made.”

**ANSWER:** optionsXpress admits that an email exchange occurred between optionsXpress employees on August 20, 2009 containing the first two quoted excerpts in Paragraph 76. optionsXpress admits that an optionsXpress employee sent an email to Feldman on August 20, 2009 containing the third quoted excerpt in Paragraph 76. optionsXpress admits that this occurred after new procedures were instituted. optionsXpress denies the remaining allegations in Paragraph 76.

77. The buy-ins for these “largest clients,” the Customers, were treated differently than the buy-ins for optionsXpress’ other customers. Those other customers were treated less favorably by optionsXpress. As explained by one of the traders: “For list #1, [a trader] will take care of contacting the big names: [including Feldman and the other Customers]. If any other names are on list #1 that are not above, go ahead and place market orders to cover at 8:25 a.m. and send the normal email notification to the customers.”

**ANSWER:** optionsXpress admits that an email was sent on September 3, 2009 containing the quoted language in Paragraph 77. optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the remaining allegations in Paragraph 77 and, therefore, denies those allegations.

78. When optionsXpress received complaints from other customers who received buy-ins without prior notice, optionsXpress responded that it was complying with Reg. SHO (“I again apologize for this inconvenience, but we are following the SEC regulations regarding short selling.”); (“The rule clearly states on page 6, section B, that any short position that cannot be delivered, must be closed out ‘immediately.’”); (“I understand your frustration over this buy in, but even though you held the security for six months, we couldn’t continuously locate the shares to hold against your position. I will be happy to credit back your commission, but the loss will not be reinstated by optionsXpress. This is a risk of shorting stocks.”).

**ANSWER:** optionsXpress admits that an email was sent by an optionsXpress employee to a customer on September 15, 2009 containing the first quoted excerpt in Paragraph 78. optionsXpress admits that an email was sent by an optionsXpress employee to a customer on October 26, 2009 containing the second and third quoted excerpts in Paragraph 78.

optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the remaining allegations in Paragraph 78 and, therefore, denies those allegations.

79. An optionsXpress trader forwarded Feldman a copy of Rule 204 as part of the implementation of the new procedures. optionsXpress' Clearing Department had previously sent Feldman a copy of Rule 204 on August 3, 2009.

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 79 and, therefore, denies the allegations.

80. On August 21, 2009, Feldman asked if he could "roll the AUG 5 short calls to SEP 5 calls during the day Friday? If I did, they wouldn't be assigned over the weekend . . . then whatever I end up with is like a new position to be dealt with Monday morning, isn't it?" An optionsXpress trader replied: "It all comes down to end of the day, what are we net. If you did roll the Aug 5 calls, then we have shares of AIG that we failed to cover. We can use the exercises/assignments to cover the short shares on expiration, but we can't turn around and say exercises/assignments don't apply to short positions at the end of the day, this is a huge red flag to the SEC."

**ANSWER:** optionsXpress admits that an email exchange occurred between an optionsXpress employee and Feldman on August 21, 2009 containing the quoted language in Paragraph 80. optionsXpress denies the remaining allegations in Paragraph 80.

**Compliance Says "Absolutely Not" to the Buy-Writes**

81. On August 20, 2009, one of the optionsXpress traders asked the Compliance Department if they could continue to place the buy-writes. A compliance officer responded citing Reg. SHO and the Rule 204 issuing release: "we . . . must execute the buy-in on the open for the specified amount to cover the fail. The customer then can do whatever other transaction they want but it is a separate transaction." He also reminded the trader that "[i]t is expected that buy-ins are occurring at or close to the open, within the first 30 minutes of trading has been accepted to be the 'beginning' of trading hours."

**ANSWER:** optionsXpress admits that an email exchange occurred between optionsXpress employees on August 20, 2009 containing the quoted language in Paragraph 81. optionsXpress denies the remaining allegations in Paragraph 81.

82. A second compliance officer also responded: "the answer is absolutely not. We do not want to be an active party in the call transactions. We are fulfilling our obligation to issue the buy-in. If we process the buy-write, regulators could consider the buy-ins as sham transactions." That compliance officer forwarded his response to another compliance officer adding: "I believe that if we do the buy-write for them, auditors will consider them sham transactions as the SEC did with the two fined prop trading institutions [Hazan and TJM]."

**ANSWER:** optionsXpress admits that an optionsXpress employee sent an email on August 20, 2009 containing the quoted language in Paragraph 82.

83. After receiving the guidance from the compliance officers, the optionsXpress trader told the other traders: "Compliance is telling us that buy-writes can no longer be used to cover a buy-in. We must place the orders separately. Since this will ultimately shut down these orders, we can place them another way. . . . Execution will put in market orders to cover the shares at the open. All we require the customer to do is call in and place a not held option order with execution. The outcome will basically be the same, but two separate orders will be in customers [sic] account, which the SEC wants to see."

**ANSWER:** optionsXpress admits that an email was sent on August 20, 2009 containing the quoted language in Paragraph 83. optionsXpress denies the remaining allegations in Paragraph 83.

84. Despite the guidance that the Customers needed to call in an order for the sale of the options, this did not necessarily occur. As Feldman told an optionsXpress senior officer in a November 2009 email: "I usually give 'standing orders' to [the optionsXpress trader] and don't even talk to him each day."

**ANSWER:** optionsXpress admits that Feldman sent an email to an optionsXpress employee on November 30, 2009 containing the quoted language in Paragraph 84. optionsXpress denies the remaining allegations in Paragraph 84.

85. Following the issuance of the new procedures, the traders generally entered the buy-in order at or before market open, but marked the order as "do not send to exchange"—meaning that the order was not automatically routed to an exchange for execution.

**ANSWER:** optionsXpress admits that traders used the “do not send to exchange” button for execution. optionsXpress denies the remaining allegations in Paragraph 85.

86. Instead, the traders paired the stock order with the option order and called a floor broker to manually place the buy-write later in the day. This change did not substantively alter the buy-write procedures except the Customers contacted optionsXpress earlier in the day.

**ANSWER:** optionsXpress admits that generally, for the buy-write transactions apparently at issue here, traders would pair stock orders with option orders and call a floor broker to manually place the trade. optionsXpress denies the remaining of the allegations in Paragraph 86.

87. According to an optionsXpress senior officer, the buy-writes would not be executed at market open because they were being sent to a floor broker on a best efforts basis.

**ANSWER:** Paragraph 87 does not identify with particularity the statement referenced; thus, optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 87 and, therefore, denies the allegations.

88. Nonetheless, Stern allowed the Customers’ buy-writes to continue.

**ANSWER:** optionsXpress denies the allegations in Paragraph 88.

**optionsXpress Limits the Number of Buy-Writes Due to Regulatory Risk  
But Allows Them to Continue**

89. On September 8, 2009, optionsXpress limited Feldman to no more than 8,000 short contracts in AIG. An optionsXpress senior officer explained to Feldman that there was a risk that the regulators could say that the buy-write activity was prohibited.

**ANSWER:** optionsXpress admits that an optionsXpress employee sent Feldman an email on September 8, 2009 requesting that Feldman limit his AIG position to no more than 8,000 short contracts. optionsXpress admits that Peter Bottini stated at his deposition that “in discussions with Mr. Feldman, I indicated that I was concerned about market risk and one of the market risks would be an interpretation by a regulator that the action of selling calls and buying

stock in a hard-to-borrow security might be scrutinized and that the actions might be deemed not appropriate.” optionsXpress denies the remaining allegations in Paragraph 89.

90. According to the optionsXpress senior officer: “I spoke several times [with Feldman] about my concerns about being involved in an investigation into the trading behavior that they were engaged in. I indicated that I was concerned about market risk and one of the market risks would be an interpretation by a regulator that the action of selling calls and buying stock in a hard-to-borrow security might be scrutinized and that the actions might be deemed not appropriate.”

**ANSWER:** optionsXpress admits that the deposition transcript of its employee contains the language quoted in Paragraph 90, but optionsXpress denies that this quoted language accurately reflects the testimony of the optionsXpress employee referenced because the quote has been taken out of context. optionsXpress denies the remaining allegations in Paragraph 90.

91. The senior officer also told one of the other Customers that the trading “may attract attention.”

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 91 and, therefore, denies the allegations.

#### **optionsXpress Receives a Letter of Caution from CBOE**

92. On September 23, 2009, optionsXpress received a letter of caution from CBOE. CBOE noted that optionsXpress’ procedures called for a buy-in on the morning of T+4, but found that the firm called certain customers prior to the execution of those buy-ins, which was a deviation from optionsXpress’ procedures. That deviation allowed the Customers to buy themselves in with a buy-write.

**ANSWER:** optionsXpress admits that it received a letter of caution from CBOE on September 23, 2009 and that the letter speaks for itself. optionsXpress denies the remaining allegations in Paragraph 92.

93. In response, to CBOE’s concerns, optionsXpress claims they began emailing the Customers, instead of calling them. Otherwise, there were no changes and optionsXpress continued to execute the Customers’ buy-writes.

**ANSWER:** optionsXpress denies the allegations in Paragraph 93.

**An optionsXpress Trader Refuses to Execute the Buy-Writes  
But Is Told to Continue**

94. On September 23, 2009, the same day that optionsXpress received the CBOE letter of caution, an optionsXpress trader forwarded a copy of the Hazan order to an optionsXpress senior officer at 8:16 a.m., citing the language about sham transactions. The trader then stated: "I am not placing any orders today." The senior officer responded minutes later: "Please execute the buy ins and customer orders today. Compliance has reviewed and is not convinced this applies. They have asked our regulator for an opinion and have not received it."

**ANSWER:** optionsXpress admits that an optionsXpress employee sent an email to other optionsXpress employees that included a link to the *Hazan* order and certain excerpts from the order. optionsXpress admits that a different optionsXpress employee responded with the first quoted excerpt in Paragraph 94. optionsXpress admits that a third optionsXpress employee responded with the second quoted excerpt in Paragraph 94. optionsXpress denies the remaining allegations in Paragraph 94.

95. At 9:02 a.m., an optionsXpress compliance officer sent an email to a group of senior executives, including Stern: "We addressed this issue back in August when the SEC issued its findings in these cases. Although I see issues with what our customers are doing, I pointed out distinguishing factors in my response back in August. . . . Additionally, we have responded to four inquiries regarding this issue: one from CBOE and three from FINRA. While the FINRA issues are still ongoing, CBOE didn't seem to have any issues with our response."

**ANSWER:** optionsXpress admits that an optionsXpress employee sent an email on September 23, 2009 containing the quoted language in Paragraph 95. optionsXpress denies the remaining allegations in Paragraph 95.

96. On the same day, the Clearing Department sent an email to the Compliance Department noting that the Compliance Department had previously addressed the issue by saying buy-writes were not allowed: "Don't want to get anyone in trouble, but somewhere down the road this is going to bite us."

**ANSWER:** optionsXpress admits that an optionsXpress employee sent an email on September 23, 2009 containing the quoted language in Paragraph 96. optionsXpress denies the remaining allegations in Paragraph 96.

97. Also, on the same day, optionsXpress emailed the *Hazan* order to Feldman.

**ANSWER:** optionsXpress admits that an optionsXpress employee sent the *Hazan* order to Feldman via email on September 23, 2009. optionsXpress denies the remaining allegations in Paragraph 97.

#### **optionsXpress Calls FINRA and the SEC**

98. On September 24, 2009, optionsXpress' in-house counsel, Stern, and two compliance officers called FINRA to ask questions about the trading. FINRA said it would not discuss the issue because of its ongoing investigation.

**ANSWER:** optionsXpress admits the allegations in Paragraph 98, except that optionsXpress denies that this allegation identifies all individuals who were on the referenced call.

99. The same day, optionsXpress' in-house counsel, Stern, and the two compliance officers called the SEC's Division of Trading and Markets ("Trading & Markets"). According to optionsXpress, Trading & Markets told optionsXpress to "keep doing what you're doing—keep closing out" and that Trading & Markets would get back to the firm on whether it had a best execution obligation requiring it to combine the Customers' buy-in orders with the sale of calls as buy-writes.

**ANSWER:** optionsXpress admits that a call between optionsXpress employees and Trading and Markets personnel occurred on September 24, 2009. optionsXpress admits that the optionsXpress employees who participated in the call recalled Trading and Markets making the statements referenced in Paragraph 99. optionsXpress denies the remaining allegations in Paragraph 99.

100. However, the trading example that optionsXpress gave to Trading & Markets, as well as other information optionsXpress provided on the call, were inaccurate and incomplete.

**ANSWER:** optionsXpress denies the allegations in Paragraph 100.

101. Upon further investigation, Trading & Markets learned additional facts that optionsXpress did not disclose on the call, including that FINRA had an open investigation and that the customers were using deep-in the-money calls to circumvent Reg. SHO. As a result, on October 2, 2009, Trading & Markets called optionsXpress and spoke to its in-house counsel and Stern telling them that the SEC declined to get involved and that it could provide optionsXpress with “no comfort.”

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in the first sentence of Paragraph 101 and, therefore, denies those allegations. optionsXpress denies the remaining allegations in Paragraph 101.

102. After the October 2, 2009 call with Trading & Markets, optionsXpress’ in-house counsel, Stern, and two compliance officers called FINRA. optionsXpress told FINRA that it had received a call from the SEC, and that the SEC had declined to be involved. optionsXpress also said that it was at a loss about what to do and was seeking guidance on the activity.

**ANSWER:** optionsXpress denies the allegations in Paragraph 102.

103. FINRA told optionsXpress that if it wanted guidance, it should send a request in writing to FINRA’s general counsel or the SEC.

**ANSWER:** optionsXpress denies the allegations in Paragraph 103.

104. optionsXpress did not submit a written request for guidance to either the SEC or FINRA’s general counsel. Instead, optionsXpress continued executing the Customers’ buy-writes.

**ANSWER:** optionsXpress admits the allegations in the first sentence of Paragraph 104. optionsXpress admits that it continued executing buy-writes for certain customers in October of 2009. The Order Instituting Proceedings fails to identify the “six customer accounts at optionsXpress” described in the definition of “the Customers” contained in Paragraph 21; thus, optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 104 regarding the customer accounts

considered to be “the Customers” and, therefore, denies the remaining allegations in Paragraph 104.

105. Two weeks after the call, the Compliance Department sent an email about another Reg. SHO issue and noted that “[w]e are already under heavy scrutiny from regulators on our short sale practices, and this problem could push us over the edge.”

**ANSWER:** optionsXpress denies the allegations in Paragraph 105 to the extent they reference an unspecified phone call. optionsXpress admits that an optionsXpress employee sent an email on October 14, 2009 containing the quoted language in Paragraph 105, among other omitted language that would give the quoted language proper context. optionsXpress denies the remaining allegations in Paragraph 105.

**Feldman Transfers Part of His Account to Another Broker-Dealer**

106. In early November 2009, Feldman transferred part of his holdings from optionsXpress to another broker-dealer based on a recommendation from a floor broker through whom some of the buy-writes were being traded. Feldman had negotiated a deal with the floor broker for lower costs based on the volume of the daily buy-writes.

**ANSWER:** optionsXpress admits that Feldman transferred part of his holdings from optionsXpress to another broker-dealer in November 2009. optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the remaining allegations in Paragraph 106 and, therefore, denies those allegations.

107. Less than a month later, Feldman transferred his positions back to optionsXpress because the new broker-dealer’s clearing broker did not want the business.

**ANSWER:** optionsXpress admits that Feldman transferred his positions back to optionsXpress. optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the remaining allegations in Paragraph 107 and, therefore, denies those allegations.

108. In an internal email the clearing broker noted that because Feldman was getting assigned every day on the buy-write calls “the position is continuously on the books. In other

words his 'cover' never removes the position because a new assignment recreates it and in the CNS world it is the same position continuously open on the books."

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 108 and, therefore, denies the allegations.

109. While at the other broker-dealer, Feldman had a series of conversations with one of its registered representatives regarding the fact that Feldman's shares were not settling. For example, Feldman explained: "I don't settle the stock@all so what diff wld t+2 be?"

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 109 and, therefore, denies the allegations.

110. Upon being told that the clearing broker planned to settle the stock before transferring the position back to optionsXpress, Feldman stated: "They are going to settle the stock? [The clearing broker] is going to settle that, actually settle the stock?"

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 110 and, therefore, denies the allegations.

111. After receiving an assignment notice on Sears, Feldman emailed: "So how many SHLD do I have to buy-in today (to avoid settlement)?"

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 111 and, therefore, denies the allegations.

112. Similarly, in a phone conversation discussing how Feldman would cover shares of Sears that were going to settle on a certain date, Feldman stated: "So I could do a buy-write and then I wouldn't settle," to which the registered representative replied, "Exactly. You do a buy-write so you don't . . . ."

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 112 and, therefore, denies the allegations.

113. Feldman and the registered representative also discussed the fact that there were daily assignments. For example, the registered representative explained to Feldman: "See the problem is if I roll today it doesn't really solve anything because you're just going to get assigned again and again and again." He also explained to Feldman that optionsXpress could not transfer his deep-in-the-money calls because "they wouldn't have the DEC 30 calls to deliver until they settle but they settle and are assigned same day so nothing to move."

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 113 and, therefore, denies the allegations.

114. The registered representative also told Feldman that there was no reason the counterparty would not exercise the options and that "market-makers are always going to assign what you're short." Feldman had a similar conversation with a trader at optionsXpress who explained: "the market maker is usually always going to assign whatever call [it purchases] . . . normally you'll always going to get assigned," to which Feldman replied, "Yeah that's what I'm saying."

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 114 and, therefore, denies the allegations.

115. When Feldman was asked to leave the new broker-dealer, he and the registered representative also discussed which brokers would allow Feldman to continue the trading and concluded that it would be difficult to find one. As Feldman summarized: "Right, so they [another clearing firm] might let you get away with certain things because they don't notice but if it doesn't fit their rules, they're not going to make any exceptions."

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 115 and, therefore, denies the allegations.

116. The registered representative also told Feldman that no other major broker-dealer was doing this type of activity. In early January 2010, Feldman also discussed with one of the optionsXpress traders that no one else on the "street" was doing the buy-writes on Sears.

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 116 and, therefore, denies the allegations.

117. The registered representative also explained to Feldman why the activity would violate Reg. SHO: "[The clearing broker] finally had a CNS fail, not net flat outside of Reg. SHO where they said their compliance told them that they had to go out and buy this stock no matter what, whether you have a net flat position in your account or not they have to go out and borrow them."

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 117 and, therefore, denies the allegations.

118. The registered representative also told Feldman that the regulators were concerned about this type of activity. "I don't think [optionsXpress is] going to take you because the CBOE regulators are starting to get heavy on this activity, that's why [the clearing broker] is getting more than likely skittish."

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 118 and, therefore, denies the allegations.

119. Nonetheless, optionsXpress allowed Feldman to return, but raised his rate for buy-ins by \$.005 per share.

**ANSWER:** optionsXpress admits that it raised the price of buy-ins for Feldman. optionsXpress denies the remaining allegations in Paragraph 119.

120. When another Customer threatened to leave optionsXpress shortly after Feldman's return, an optionsXpress senior officer told others within optionsXpress that the Customer would not be able to leave: "We had another customer [Feldman] move to [the other broker-dealer] and they were kicked back to us [ ]. They do not want this business."

**ANSWER:** optionsXpress admits that an optionsXpress employee sent an email on December 8, 2009 containing the quoted language in Paragraph 120. optionsXpress denies the remaining allegations in Paragraph 120.

**Feldman Asks about “Restarting the Clock”**

121. On December 4, 2009, an optionsXpress compliance officer explained Reg. SHO to Feldman again: “when an assignment results in a short sale in a security we are already failing to deliver, we have to take action to clean up the entire fail immediately.”

**ANSWER:** optionsXpress admits that an optionsXpress employee sent an email on December 4, 2009 to Feldman containing the quoted language in Paragraph 121. optionsXpress denies the remaining allegations in Paragraph 121.

122. Feldman responded: “Wow, that’s a wonderfully thorough explanation. . . . This gives me some food for thought. I’m wondering if there might not be some different strategies I could use to avoid buyins, or ‘restart the clock’ sometimes. Is there a time we can talk?”

**ANSWER:** optionsXpress admits that Feldman sent an email on December 4, 2009 to optionsXpress employees containing the quoted language in Paragraph 122, among other omitted language that would give the quoted language proper context. optionsXpress denies the remaining allegations in Paragraph 122.

123. optionsXpress took no action regarding Feldman’s desire to “restart” the settlement clock.

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 123 and, therefore, denies the allegations.

**optionsXpress Is Contacted by Multiple Regulators**

124. On December 15, 2009, optionsXpress received a letter of caution from FINRA for violating Rule 204T by failing to timely close out a failure-to-deliver position in October 2008.

**ANSWER:** optionsXpress admits that it received the referenced letter from FINRA dated December 15, 2009, which discusses an issue that had already been corrected by the date of that letter and speaks for itself. optionsXpress denies the remaining allegations in Paragraph 124.

125. FINRA noted in the letter that it had decided to provide a Cautionary Action Letter as a "compliance aid to assist the Firm in ensuring that it is in compliance with SEC Rule 204T;" however, "any subsequent violations of SEC Rule 204T may result in disciplinary action."

**ANSWER:** optionsXpress admits that the FINRA letter dated December 15, 2009 contains the quoted language in Paragraph 125. optionsXpress denies the remaining allegations in Paragraph 125.

126. optionsXpress did not change its procedures following the receipt of this letter and the buy-writes continued.

**ANSWER:** optionsXpress admits that it did not change its procedures, but denies that the December 15, 2009 letter indicated that changes were necessary. Rather, the issue addressed by the letter had already been resolved prior to optionsXpress's receipt of the letter.

127. On December 30, 2009, the SEC Division of Enforcement made its first request for information to optionsXpress.

**ANSWER:** optionsXpress denies the allegations in Paragraph 127.

128. On January 14, 2010, Stern, optionsXpress' in-house counsel, and two compliance officers had a call with FINRA staff. During the call, FINRA staff expressed concern that the buy-ins did not result in a net flat or long position at the end of the day.

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 128 and, therefore, denies the allegations.

129. Despite the expression of concern from an employee of FINRA, optionsXpress continued to allow the buy-writes.

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 129 and, therefore, denies the allegations.

130. On February 12, 2010, optionsXpress sent a letter to FINRA falsely stating that “[i]nitially the customers may have been notified before the buy-in purchase was executed, but after late December 2008, they would have been notified after the buy-in purchase was executed.” The letter also contained other inaccuracies.

**ANSWER:** optionsXpress admits that it sent a letter to FINRA dated February 12, 2010 containing the quoted language in Paragraph 130. optionsXpress admits that the quoted language is inaccurate, but denies that it was drafted or sent with the intent of making a false statement. optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in the last sentence of Paragraph 130 and, therefore, denies those allegations. optionsXpress denies the remaining allegations in Paragraph 130.

131. On February 17, 2010, optionsXpress and all of the Customers received subpoenas from the SEC.

**ANSWER:** optionsXpress admits that it received a subpoena dated February 17, 2010. optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the remaining allegations in Paragraph 131 and, therefore, denies those allegations.

132. On February 23, 2010 and March 4, 2010, SEC staff told optionsXpress that they had “grave concerns” about the trading. The buy-writes continued.

**ANSWER:** optionsXpress admits that calls between representatives of optionsXpress and the staff took place on February 23, 2010 and March 4, 2010, and that the staff expressed concern about the trading in question. optionsXpress lacks and is unable to obtain sufficient

knowledge and information to form a belief as to the truth of the remaining allegations in Paragraph 132 and, therefore, denies those allegations.

**optionsXpress Increases Commissions**

133. In January 2010, after the Division of Enforcement made its first request for information, optionsXpress told Feldman that it was going to keep in place the commission increase that it imposed following Feldman's return from the other broker-dealer.

**ANSWER:** optionsXpress admits that it did not change Feldman's rates in January 2010. optionsXpress denies the remaining allegations in Paragraph 133.

134. optionsXpress told Feldman that the reasons for the increase included regulatory concerns and increased compliance costs. "We have had discussions with the regulators about these strategies. It seems several market-makers have been complaining to the regulators about them. We continue to ask the regulators for guidance on these trades. . . . it continues to be a drain on our compliance staff."

**ANSWER:** optionsXpress admits that an email was sent by its employee on January 15, 2010 containing the quoted language in Paragraph 134. optionsXpress denies the remaining allegations in Paragraph 134.

135. Several days later, optionsXpress told Feldman that "[r]egulators continue to ask questions, we provide answers and ask for guidance."

**ANSWER:** optionsXpress admits that an email was sent by its employee on January 19, 2010 containing the quoted language in Paragraph 135. optionsXpress denies the remaining allegations in Paragraph 135.

136. optionsXpress was not seeking guidance from regulators during this period.

**ANSWER:** The Order Instituting Proceedings does not specify what time period the allegation in Paragraph 136 refers to when using the phrase "this period" and also does not explain the meaning of the phrase "seeking guidance"; thus, optionsXpress lacks and is unable to obtain sufficient knowledge to form a belief as to the allegations in Paragraph 136 and, therefore, denies the allegations.

137. In February 2010, optionsXpress began charging the other Customers an increased commission as well. In explaining the increased commissions, a trader at optionsXpress explained that the trades were so large the regulators might start to notice.

**ANSWER:** The Order Instituting Proceedings fails to identify the “six customer accounts at optionsXpress” described in the definition of “the Customers” contained in Paragraph 21; thus, optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in the first sentence of Paragraph 137 and, therefore, denies those allegations. optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in the second sentence of Paragraph 137 and, therefore denies the remaining allegations in Paragraph 137.

138. After optionsXpress increased the commission, Feldman complained: “Millions of \$\$ inc [sic] commissions[sic],,,,yet treat me/us like criminals. . . . But, in the big picture..it’s still quite the gig..where can you get such mkt-bating [sic] retuens [sic] consistently? So, as disgusting as [optionsXpress] are [sic], have to bend over and get raped, and take the punishment,,,,”

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 138 and, therefore, denies the allegations.

#### **The Trading Finally Ceases**

139. On March 9, 2010, Stern and two other optionsXpress officers called CBOE, asking it to advocate on optionsXpress’ behalf in connection with the SEC investigation. CBOE instead referred optionsXpress to the CBOE’s regulatory circulars which discussed sham transactions.

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 139 and, therefore, denies the allegations.

140. The same day, optionsXpress decided to halt the trading, but allowed it to continue until the March options expiration. The decision to halt the trading was made by Stern and two other optionsXpress officers.

ANSWER: optionsXpress admits that it decided to halt the trading in question on or about March 9, 2010. optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the remaining allegations in Paragraph 140 and, therefore, denies those allegations.

**optionsXpress, Stern, and Feldman Knew or Were Reckless in Not Knowing  
That the Calls Would Be Exercised**

141. optionsXpress, Stern, and Feldman knew or were reckless in not knowing that the buy-write calls would be exercised and assigned.

ANSWER: optionsXpress denies the allegations in paragraph 141.

142. optionsXpress' buy-in procedures — authorized by Stern — reference the “perpetual” list and acknowledge that the list is based on the premise that the calls were being exercised and assigned on a daily basis.

ANSWER: optionsXpress denies the allegations in paragraph 142.

143. optionsXpress employees referenced the “daily,” “chronic,” “perpetual,” and “rolling” buy-ins on numerous occasions, expressed the expectation that the options would be assigned, and explained to the customers that “the market maker is usually always going to assign whatever call [it purchases] . . . normally you’ll [sic] always going to get assigned.”

ANSWER: optionsXpress admits that the terms “daily,” “chronic,” “perpetual,” and “rolling” were used by certain employees with reference to the buy-ins. optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the remaining allegations in Paragraph 143 and, therefore, denies those allegations.

144. Feldman acknowledged on numerous occasions that the options were being exercised the same day that they were sold. For example, Feldman sent an instant message to a friend: “it slmost [sic] doesn’t matter, JUL or SEP, as u get assigned that night anyway, so what’s the diff?”; emailed an optionsXpress senior officer: “a buy-write of 2500 SHLD, incurs a commission of \$1,250 each and every day”; and emailed optionsXpress’ Risk Department: “it’s part of my daily routine. Brush teeth, get coffee, rest [sic] C [Citigroup, Inc.], cover buyin on C [Citigroup, Inc.]”

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in the first sentence and the first quoted excerpt in Paragraph 144 and, therefore, denies the allegations. optionsXpress admits that an email was sent by Feldman to an optionsXpress employee on November 30, 2009 containing the second quoted excerpt in Paragraph 144. optionsXpress admits that an email was sent by Feldman to an optionsXpress employee on July 6, 2009 containing the third quoted excerpt in Paragraph 144. optionsXpress denies the remaining allegations in Paragraph 144.

145. According to Feldman: “[Y]ou’d be stupid to say, oh, I’m going to write these and none them are going to get exercised.”

**ANSWER:** optionsXpress admits that the transcript of Feldman’s April 8, 2010 testimony contains the quoted text. optionsXpress denies the remaining allegations in Paragraph 145.

146. A registered representative at Feldman’s other broker-dealer also told Feldman: “You know your counterparty is dropping on almost every one.” Dropping on almost everyone signifies that the counterparty would almost always choose to exercise the deep-in-the-money calls written by Feldman as part of the buy-write.

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 146 and, therefore, denies the allegations.

147. Feldman and the traders at optionsXpress followed the open interest and daily volume of the options.

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 147 and, therefore, denies the allegations.

148. Open interest is the number of contracts in existence at the beginning of trading. The daily volume is the number of contracts that traded during the day.

**ANSWER:** optionsXpress admits that open interest is the number of contracts in existence at the end of the prior day of trading. optionsXpress admits the allegations in the second sentence of Paragraph 148.

149. Feldman admitted that he used the open interest to determine which options he would use and that he paid "a lot of attention to" the volume.

**ANSWER:** optionsXpress admits that the transcript of Feldman's April 8, 2010 testimony reflects statements consistent with the allegations in Paragraph 149. optionsXpress denies the remaining allegations in Paragraph 149.

150. An examination of the open interest and volume would have shown that the call options were being exercised the same day. For example, the following is the open interest and volume on SHLD January 5 calls:

| Date          | optionsXpress<br>Buy-Write | Volume Traded | Open<br>Interest |
|---------------|----------------------------|---------------|------------------|
| Nov. 27, 2009 | 1359                       | 1359          | 2                |
| Nov. 30, 2009 | 1383                       | 1383          | 2                |
| Dec. 1, 2009  | 1407                       | 1407          | 2                |
| Dec. 2, 2009  | 1525                       | 1525          | 2                |

**ANSWER:** optionsXpress denies the allegations in Paragraph 150.

151. When asked by a registered representative what the open interest was on a particular option strike, Feldman replied: "probably not very high because they exercise." Similarly when a registered representative told Feldman "you should of got assigned on 1914 according to open interest." Feldman replied: "Yup, since 214 of [ ] stayed open and OI [open interest] was 300. Good use of math!"

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 151 and, therefore, denies the allegations.

152. Further, it generally made no economic sense for the counterparty not to exercise the options (and, therefore, maintain a short stock position). The counterparty faced the same carrying costs as the Customers (i.e., it would have to pay the hard to borrow rate on shares sold short). Also, every day that the options were exercised the Customers needed to do more buy-writes. The counterparty was making a penny or more a share each day that the Customers did the buy-writes. If the options were not exercised, then the counterparty would have not only been

exposed to the borrow rate, but would have lost out on a guaranteed return of one penny a share the following day.

**ANSWER:** optionsXpress denies the allegations in Paragraph 152.

**Feldman and OptionsXpress Knew the Effect of the Trading**

153. In late 2009 and early 2010, Feldman discussed with a friend an electronic message board where there was speculation regarding the buy-write activity. In late December, the friend told Feldman that the participants in the message boards “think Sears is buying back shares. . . . they have no idea.”

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 153 and, therefore, denies the allegations.

154. In late January, when the message board posts were discussing daily “mystery trades,” “illusory trades,” and “faux trades” in Sears, including possible manipulation of its daily trading volume and violations of Reg. SHO, Feldman told his friend: “I read the latest thread on the SHLD ‘volume spikes’. Very entertaining. (Until someone notifies the SEC and they shut down the strategy!!).”

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 154 and, therefore, denies the allegations.

155. Feldman also admitted that he was aware that “everybody was out there just like getting worked up in a tizzy.” In fact, he bragged about his effect on the market to the floor broker who executed the buy-writes.

**ANSWER:** optionsXpress admits that the transcript of Feldman’s April 8, 2010 testimony contains the quoted text. optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the remaining allegations in Paragraph 155 and, therefore, denies the allegations.

156. Feldman also reviewed a website which discussed the “manipulative” activity noting that it was “consistent with the illegal ‘reset’ transaction” described in *Hazan*.

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 156 and, therefore, denies the allegations.

157. Feldman sold options knowing that the calls would be exercised and assigned, and that he did not intend to deliver the shares by settlement date, and in fact on numerous occasions he did not deliver the shares as required. In doing this "stock kiting," he deceived clearing brokers and the ultimate purchasers (or recipients) of the stock about his intention to deliver the shares.

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in Paragraph 157 and, therefore, denies the allegations.

158. Feldman's use of buy-writes was the equivalent of doing matched orders. Feldman used the buy-writes (and optionsXpress allowed him to use the buy-writes) for the improper purpose of appearing to close out delivery fails without actually delivering the shares. Feldman's use of buy-writes was a manipulative device and deceived the market.

**ANSWER:** optionsXpress denies the allegations in Paragraph 158.

159. When optionsXpress and Feldman failed to deliver shares, the unsettled position was assigned via lottery to clearing brokers who had a net purchase of shares on that day and thus to the ultimate purchasers of those shares. These ultimate purchasers and clearing brokers reasonably presumed that they would receive the shares they bought in the open market (within the standard three-day settlement period), when in fact they did not.

**ANSWER:** optionsXpress lacks and is unable to obtain sufficient knowledge and information to form a belief as to the truth of the allegations in the first sentence of Paragraph 159 and, therefore, denies those allegations. optionsXpress denies the remaining allegations in Paragraph 159.

160. Indeed, many of the clearing brokers submitted notices to CNS (who in turn sent them to optionsXpress) requesting immediate delivery of the shares that were not delivered by settlement date.

**ANSWER:** optionsXpress admits that it received notices requesting delivery of shares from CNS. optionsXpress lacks and is unable to obtain sufficient knowledge and information to

form a belief as to the truth of the remaining allegations in Paragraph 160 and, therefore, denies those allegations.

161. When a seller of securities fails to deliver securities on settlement date, the seller effectively unilaterally converts a securities contract (which is expected to settle within the standard three-day settlement period) into an undated futures-type contract, to which the buyer might not have agreed, or that might have been priced differently.

**ANSWER:** optionsXpress denies the allegations in Paragraph 161.

#### **E. VIOLATIONS**

162. As a result of the conduct described above, optionsXpress willfully violated Rules 204 and 204T of Reg. SHO which require participants of a registered clearing agency to deliver securities by settlement date. If the participants do not deliver securities by settlement date in connection with a short sale, they must purchase or borrow securities of like kind and quantity to close out the failure-to-deliver position by no later than the beginning of regular trading hours on the settlement day following the settlement date.

**ANSWER:** The allegations in this portion of the Order Instituting Proceedings contain legal conclusions for which no answer is required. To the extent an answer is required, optionsXpress denies the allegations.

163. As a result of the conduct described above, Feldman willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rules 10b-5 and 10b-21 thereunder which prohibit fraudulent conduct in the offer or sale of securities and in connection with the purchase or sale of securities.

**ANSWER:** The allegations in this portion of the Order Instituting Proceedings contain legal conclusions for which no answer is required. To the extent an answer is required, optionsXpress denies the allegations.

164. As a result of the conduct described above, Stern caused and willfully aided and abetted optionsXpress' violations of Rules 204 and 204T and Feldman's violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rules 10b-5 and 10b-21 thereunder.

**ANSWER:** The allegations in this portion of the Order Instituting Proceedings contain legal conclusions for which no answer is required. To the extent an answer is required, optionsXpress denies the allegations.

165. As a result of the conduct described above, optionsXpress caused and willfully aided and abetted Feldman's violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rules 10b-5 and 10b-21 thereunder.

**ANSWER:** The allegations in this portion of the Order Instituting Proceedings contain legal conclusions for which no answer is required. To the extent an answer is required, optionsXpress denies the allegations.

### **AFFIRMATIVE DEFENSES**

1. The allegations and remedies sought in the Order Instituting Proceedings are barred because the statutes and regulations the Commission seeks to enforce are unconstitutionally vague under the United States Constitution. Accordingly, on such constitutional grounds, the counts against optionsXpress are unenforceable and fail to state a cause of action in that there is no reasonable basis upon which optionsXpress would have known in advance that the conduct alleged by the Commission was allegedly unlawful and/or otherwise proscribed by law.

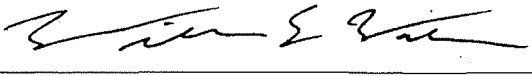
2. optionsXpress reserves the right to supplement its Answer with additional defenses that become available or apparent during the course of investigation, preparation, or review of the Commission's investigative file and to amend its answer accordingly.

### **CONCLUSION**

optionsXpress respectfully requests the Court to reject the allegations made against it by the Commission and enter an Order in favor of optionsXpress.

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Respectfully Submitted,

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